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SECURED TRANSACTIONS

The New York UCC Comes of Age: Part II

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Early last year, this column reported enthusiastically on efforts of certain New York bar associations, legislators and others to bring the New York Uniform Commercial Code into the 21st century.¹ The need for modernizing the statute was obvious. New York was the only state that had not adopted amendments to Articles 3 (negotiable instruments) and 4 (bank deposits and collections) recommended as far back as 1990 by the Uniform Law Commission (the ULC, also known as the National Commissioners on Uniform State Laws) and the American Law Institute (ALI)—its Articles 3 and 4 being the 1968 versions of those articles. Its Article 1 (general provisions) and Article 7 (documents of title) similarly failed to reflect the latest recommended provisions (being those proposed by the ULC and ALI in 2001 for Article 1² and in 2003 for Article 7.³ And it had not adopted the 2010 amendments to Article 9.⁴

As the primary U.S. commercial law jurisdiction, the New York UCC's woefully laggard status created significant issues for practitioners and financial institutions alike. Mismatches between the New York UCC and other state statutes created fertile ground for errors in documents, and a growing inability to apply judicial decisions under other state UCC laws to New York (and vice versa). Industry associations were concerned it threatened New York's status as the jurisdiction of choice for conducting domestic and international business.

The proposed 2010 amendments to UCC

Article 9 became the catalyst for a re-look at New York's entire UCC statute. Legislation to modernize the UCC (including an update of Articles 1, 3, 4, 7, 8 and 9) was proposed in June 2013 and referred to the New York State Senate Judiciary Committee in early January 2014.⁵ But, unfortunately, there it sat. Then, in May 2014, a new UCC modernization act (the 2014 Modernization Act) was introduced into the legislature,⁶ albeit this one without amendments updating Articles 3 and 4. This legislation quickly received unanimous approval of both the New York Assembly and Senate, and was signed into law on Dec. 17, 2014. Clearly, a major stumbling block to passage of the 2014 Modernization Act turned out to be New York's antiquated Articles 3 and 4, which sadly remain firmly rooted in the 20th century.⁷

The Amendments

The amendments to Articles 1, 7 and 9⁸ contained in the 2014 Modernization Act have been the subject of a number of recent articles (including this column last year) and highlights will be summarized just briefly below. To further assist practitioners, this column will also focus on non-uniform provisions, including the transition provisions (or lack thereof) for the Act, which have turned out to be one of its unexpectedly challenging aspects.

Article 1. Entitled "General Provisions," Article 1 contains definitions, underlying principles and fundamental concepts that apply throughout the different articles of the UCC. The 2014 Modernization Act contains a number of formatting changes that will bring section references in line with other state UCC stat-

utes. There are also several notable substantive changes. Revised NY UCC §1-303 (course of performance, course of dealing, and usage of trade) will allow "course of performance" to be used in addition to "course of dealing" and "usage of trade" to interpret a contract. A new §1-102 (scope of article) clarifies that the substantive rules of Article 1 apply only to a transaction to the extent such transaction is governed by another UCC article. NY UCC §1-103 (construction of Uniform Commercial Code to promote its purposes and policies; applicability of supplemental principles of law) now provides that, unless "displaced" by UCC provisions, general principles of law and equity, such as the capacity to contract, estoppel, duress, principal and agent, and the law merchant, are not pre-empted but rather supplement the UCC.

In regard to non-uniform changes, the most significant is a change that the 2014 Modernization Act did *not* make. It did not adopt the uniform version of "good faith" consisting of "honesty in fact and the observance of reasonable commercial standards of fair dealing." Instead, it preserved the subjective existing New York definition of "honesty in fact in the transaction or conduct concerned."⁹

Notable non-uniform changes include removing from the definition of "conspicuous"¹⁰ the safe harbor statements that a printed heading in capitals, language in the body of a form in larger or other contrasting type or color, or any stated term in a telegram are "conspicuous." In addition, the choice of law rules for UCC transactions (moved from §1-105(1) to §1-301) continue to permit parties

to choose New York as the governing law if the transaction bears a “reasonable relation” to the state. However, a non-uniform provision was added requiring New York state law to apply to any transaction to which a consumer who is a New York state resident is party.

Other non-uniform revisions include retaining a specific UCC (non-uniform) statute of frauds provision (formerly §1-206 and now §1-207) relating solely to sale of personal property.¹¹ In addition, the Act adopted only part of revised §1-308 (performance or acceptance under reservation of rights) so as to preserve existing New York law on accord and satisfaction—permitting an express reservations of rights to avoid an accord and satisfaction otherwise effected by a payment or acceptance of a payment (contained in former §1-207).

Article 7. UCC Article 7 deals with documents of title for goods. Specifically, it governs warehouse receipts, bills of lading, delivery orders and other documents that typically serve as evidence of the holder’s right to control the related goods.¹² Article 7 also addresses the transfer of rights in shipped or stored goods, such as warehousemen and carriers’ liens, and their enforcement, as well as allocation of the risk of loss of such goods.

Like NY UCC Articles 3 and 4, NY UCC Article 7 became effective in 1964 based on the original 1951 version of the statute, and has changed little since then. The most recent uniform amendments to such article were proposed by the ULC and ALI in 2003.

Most notably, the 2014 Modernization Act updates Article 7 by recognizing electronic documents of title. The Act revises the definition of “document of title” in NY UCC §1-201 to provide for electronic documents.¹³ Similar to the treatment of electronic chattel paper under Article 9, revised Article 7, through a new NY UCC §7-106, establishes procedures for achieving “control” of an electronic document of title, equivalent to possession and indorsement of a tangible document of title. Revised NY UCC §7-105 also establishes rules pursuant to which a tangible document of title may be issued in substitution for an electronic document, and vice versa.

No material non-uniform revisions to Article 7 were effected pursuant to the 2014 Modernization Act.

Articles 8 and 9. The revisions to Article 9 contained in the UCC 2010 amendments and

now implemented through the 2014 Modernization Act have been the subject of many recent treatises and articles, as well as previously discussed in this column.¹⁴ As of the date of submission of this article, the 2010 UCC amendments have been adopted in 49 states (Oklahoma being the sole exception) plus the District of Columbia and Puerto Rico.¹⁵

Clearly, a major stumbling block to passage of the 2014 Modernization Act turned out to be New York’s antiquated Articles 3 and 4, which sadly remain firmly rooted in the 20th century.

Among the most notable changes effected by the 2010 amendments is implementation of rules for determining the correct debtor names when filing financing statements against individual debtors. The Modernization Act adopts the Alternative A rule (the “only if” rule), one of two alternative approaches to individual debtor name filings. Under Alternative A, the debtor’s name on such person’s driver’s license is the only correct name to use for filing against an individual debtor. Under the other approach (Alternative B (the “safe harbor” rule)), the name on a driver’s license is a correct name, but not the only correct name, against which to file. Alternative A is by far the preferred choice of jurisdictions, being the law in all but 7 of the 51 jurisdictions that adopted the UCC 2010 amendments.¹⁶

The 2014 Modernization Act claims two interesting non-uniform sets of changes to Article 9. The first modifies NY UCC §9-104 (control of deposit account), the text of which was untouched by the uniform 2010 amendments.

Similar to provisions in the Delaware UCC, new subsections (a)(4) and (a)(5) now make it clear that a secured party has “control” over a deposit account if the deposit account is in the name of the secured party or indicates that the secured party has a security interest in such deposit account. In addition, it is made clear that control can be effected through another person who has control or (assuming such person already has control) acknowledges control of the deposit account

on behalf of the secured party.

In addition, three new subsections (c), (d) and (e) were added to NY UCC §9-104. Subsection (c) is a protective provision with respect to a depositary bank stating that such bank does not undertake any implied duties by virtue of entering into a control agreement, naming an account in the name of a secured party or indicating a secured party has a security interest in an account. Subsection (d) confirms that a secured party has control over a deposit account if it satisfies the requirements for control otherwise contained in §9-104, even if the obligation of the depositary bank to comply with instructions originated by the secured party is subject to conditions other than consent of the debtor. Finally, subsection (e) states that the new method of control obtained by attaching the secured party’s name to a deposit account doesn’t create any inferences in regard to the sufficiency of compliance with other control methods.

The second set of non-uniform provisions modifies Article 8. First, a new subsection (h) has been added to NY UCC §8-103 (rules for determining whether certain obligations and interests are securities or financial assets). This subsection provides that an interest in an issuer is not a “security” under Article 8 merely because the issuer maintains records other than for registration of transfer or *could* but doesn’t maintain books for registering transfers. This modification responds to (and overrules) the controversial ruling in *Highland Capital* by the New York State Court of Appeals.¹⁷ In *Highland*, the court ruled that promissory notes not traded on an exchange could, in certain circumstances, constitute securities under Article 8 rather than instruments under Article 3. The court reasoned that since the definition of “security” under UCC §8-102(a) (15) includes interest in an issuer or its property “the transfer of which may be registered upon books maintained for that purpose, by or on behalf of the issuer,” and since in that case the maker of the notes could (although it did not) maintain such a registry, then the notes would be considered “securities.”

In addition, new language (similar to new NY UCC §9-104(c) and (d), as described above) has been added to §8-106 (control) clarifying that a “purchaser” (secured party) has “control” over securities even if any duty of the issuer or securities intermediary originated by the

purchaser is subject to conditions (other than further consent by the registered owner or the entitlement holder). It further states that authentication of a control agreement does not impose on the issuer or securities intermediary any implied duty.

As with Article 1 above, it is important to note the 2010 Article 9 uniform amendments that were *not* adopted pursuant to the 2014 Modernization Act. These include revisions to NY UCC §9-105 (control of electronic chattel paper) that would have provided a safe harbor for control of electronic chattel paper; to NY UCC §§9-406 (restrictions on assignment of accounts, chattel paper, payment intangibles, and promissory notes ineffective¹⁸) and 9-408 (restrictions on assignment of promissory notes, health-care-insurance receivables, and certain general intangibles ineffective) to clarify that foreclosure sale of a payment intangible or promissory note is governed by the anti-assignment rules of §9-406 and not §9-408; to NY UCC §9-516(b)(5)(C) (what constitutes filing; effectiveness of filing) that would have allowed a filing office to reject a financing statement that did not indicate an organizational debtor's type or jurisdiction or organization or organizational ID number; and to NY UCC §9-518 (claim concerning inaccurate or wrongfully filed record) that would have allowed a secured party of record to file an information statement (still called a "correction statement" in the NY UCC) indicating another person has filed an unauthorized termination statement or other record with respect to its financing statement.

Transition Rules

The uniform 2010 amendments to Article 9 contain in Part 8 a finely honed set of transition provisions, similar to the rules for the 2001 amendments, designed to facilitate an orderly transition to new rules. New York, on the other hand, failed to incorporate the Part 8 rules or, in fact, *any* transition rules, either for Article 9 or any of the other articles being amended. Instead, the 2014 Modernization Act states simply that it takes effect "immediately" and applies to "transactions entered into on or after such date."

This of course creates a quandary for practitioners. "Transactions" is not a defined term in the UCC. While the 2010 uniform amendments provide explicit grace periods to permit parties

to amend or file "in-lieu" financing statements to comply with the new requirements, counsel seeking to abide by New York law have no such structure. Theoretically, any change in collateral or additional advance under or amendment to a loan facility existing prior to the Dec. 14, 2014 effective date could constitute a "transaction," requiring a complying amendment to the related financing statement filing. By the same token, a financing statement filed with respect to a transaction that is entirely static, with no amendments, additional advances or changes in collateral after Dec. 17, 2014 need never be amended.

In addition, given that there is no clear mandate to amend certain pre-existing filings for "static" transactions, creditors may need to conduct lien searches for a potentially indefinite period against pre-2014 Modernization Act compliant individual debtor or registered organization names.

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The 2010 uniform amendment transition rules make it clear that certain new requirements need not be met in respect of pre-existing financing statements. For example, the 2010 amendments require certain financing statements to indicate whether collateral is being administered by a decedent's personal representative or is held in a trust. However, §9-805(e) of the uniform 2010 amendments allows financing statements filed prior to the amendment effective date to remain effective even though they do not contain such new language. On the other hand, there is no such "grandfather" clause in the New York statute.

Conclusion

The 2014 Modernization Act was certainly a major and welcome step forward for New York commercial law. It is unfortunate that Articles 3 and 4 continue to lag, but hopefully that will be corrected soon. What is also unfortunate,

however, is the lack of clear transitional rules under the Act, which may burden practitioners for years to come.

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1. See Barbara Goodstein, "The New York UCC Comes of Age," 251 N.Y.L.J. 63 (April 3, 2014).

2. The amendments to Article 1 are now effective in all states except Georgia, Missouri and Wyoming. Puerto Rico has also not adopted the 2001 amendments to Article 1. However, proposed legislation adopting such amendments has been introduced in Wyoming as of the date of submission of this article. See <http://www.uniformlaws.org>.

3. The amendments to Article 7 have not been adopted in Missouri and Wyoming. The amendments are also not effective in either Puerto Rico or the Virgin Islands. However, as with the 2001 Article 1 revisions, as of the date of submission of this article, proposed legislation adopting such amendments has been introduced in Wyoming. See <http://www.uniformlaws.org>.

4. As of the date of submission of this article, Oklahoma is the only state that has not adopted the 2010 amendments, although they are currently proposed for adoption in such state. They are also not effective in the Virgin Islands. See <http://www.uniformlaws.org>.

5. 2013 NY Senate Bill S5901.

6. Assembly Bill 9933 was introduced on May 30, 2014 by Assemblywoman Helene E. Weinstein. The same legislation was subsequently introduced in the Senate on June 11, 2014.

7. See Goodstein, *supra* note 1, for a brief summary of the amendments that were proposed for New York Articles 3 and 4.

8. There are also certain amendments discussed below to Article 8, and limited conforming and other revisions to Articles 2 and 2-A that are beyond the scope of this article.

9. NY UCC §1-201(b)(20). Note, however, that Article 2 (sales) in NY UCC §2-103(b) continues to define "good faith" in the case of a merchant as both honesty in fact and "observance of reasonable commercial standards of fair dealing in the trade."

10. NY UCC §1-201(b)(10).

11. Note, however, that it expressly excludes contracts for the sales of goods under NY UCC §2-201(1), contracts for the purchase or sale of securities under NY UCC §8-113 and security agreements under NY UCC §9-203, and to certain qualified financial contracts under the New York General Obligations Law.

12. See NY UCC §7-101, cmt.

13. NY UCC §1-201(B)(16) states that "[a]n electronic document of title means a document of title evidenced by a record consisting of information stored in an electronic medium. A tangible document of title means a document of title evidenced by a record consisting of information that is inscribed on a tangible medium."

14. See *supra* note 1; Alan Christenfeld and Shephard Melzer, "First Modifications Since 2001 Considered for UCC Article 9," 240 N.Y.L.J. No. 106 (Dec. 4, 2008), and Alan Christenfeld and Barbara Goodstein, "State Legislatures Consider UCC Article 9 Amendments," 245 N.Y.L.J. 105 (June 2, 2011).

15. See *supra* note 4.

16. See http://cstransactionwatch.com/wp-content/uploads/2013/06/DL_Checklist_01132015.

17. *Highland Capital Mgt LP v. Schneider*, 8 NY.3d 406 (N.Y. 2007).

18. The somewhat wordy full name of this section is "discharge of account debtor; notification of assignment; modification and proof of assignment; restrictions on assignment of accounts, chattel paper, payment intangibles and promissory notes ineffective."